

# HOUSE BILL REPORT

## SSB 5195

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### As Reported by House Committee On: Financial Institutions & Insurance

**Title:** An act relating to adopting the life settlements model act.

**Brief Description:** Adopting the life settlements model act.

**Sponsors:** Senate Committee on Financial Institutions, Housing & Insurance (originally sponsored by Senators Berkey, Swecker, Kauffman, Hobbs, King, Marr, Haugen, Franklin, Parlette, Schoesler and Shin).

#### **Brief History:**

##### **Committee Activity:**

Financial Institutions & Insurance: 3/17/09, 3/19/09 [DP].

#### **Brief Summary of Substitute Bill**

- Requires licensing of any person who buys or brokers a life insurance policy from the owner if the owner is a resident of this state.
- Establishes prohibited practices, disclosure requirements, and contractual provisions for life settlements.
- Establishes sanctions for violations of the chapter.

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### HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

**Majority Report:** Do pass. Signed by 11 members: Representatives Kirby, Chair; Kelley, Vice Chair; Bailey, Ranking Minority Member; Parker, Assistant Ranking Minority Member; Hurst, McCoy, Nelson, Roach, Rodne, Santos and Simpson.

**Staff:** Jon Hedegard (786-7127)

#### **Background:**

##### Regulatory Authority of the Insurance Commissioner.

The Insurance Commissioner (Commissioner) regulates insurance transactions in Washington. This includes life insurance policies that are issued or delivered in Washington.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

Insurance rates and insurance forms are filed with the Commissioner. The Commissioner ensures that those rates and forms comply with the Insurance Code.

#### Insurance Contracts and Insurable Interests.

A person may enter into an insurance contract in order to insure the life of another if the benefits are payable to the insured person (or their personal representative) or if the person procuring the contract has an "insurable interest" in the person insured.

#### Insurable Interest.

The insurable interest may be based in:

- a substantial personal or emotional interest in an insured stemming from close family ties;
- a substantial economic interest in the continuing life, health, or safety of an insured;
- specified financial interests related to certain contracts, business relationships, and stock option arrangements;
- certain interests of guardians, trustees, or other fiduciaries with respect to beneficiaries; or
- the interests of a nonprofit organization with respect to life insurance policies if certain criteria are met.

#### Viatical Settlements.

State insurance law regulates viatical settlements. A viatical settlement is when the owner of a life insurance policy insuring the life of a person with a catastrophic or life-threatening illness or condition, sells the policy to a third-party. The third-party pays a sum less than the death benefit and may also be required to continue any ongoing premium payments. In return, the third-party receives the right to collect the death benefit.

A person may not act as the purchaser of a viatical settlement or act as a viatical settlement broker without being licensed by the Office of the Insurance Commissioner (OIC). All viatical settlement contracts and compensation must be filed for approval with the Commissioner.

#### Accelerated Death Benefits.

Insurers may include provisions in their life insurance contracts that allow an insured to trigger an early partial payment of the death benefit if the insured meets specific eligibility standards that indicates that the insured has a short life expectancy. These provisions are regulated under state law. Contracts must be filed for approval with the Commissioner.

#### Life Settlements and Insurance Regulation.

"Life settlement" is not currently defined in the Insurance Code. There is no insurance statutory framework for a policy owner selling a life insurance policy if the transaction does not fall within the structure of a viatical settlement or an accelerated death benefit. A "life settlement" occurs when a policyholder sells their life insurance policy to a third-party (as opposed to selling it back to the insurance company that issued the policy). Typically, the seller receives more than the policy's cash surrender value but less than its net death benefit. The purchaser may hold the policies until maturity, when the insured person dies, and collect the net death benefits. They may also resell the policies, or they may sell interests in multiple policies to hedge funds or other investors. The person selling his or her policy

receives a lump sum payment. The amount of the lump sum varies depending on a range of factors including the person's age, health, and terms and conditions of the life insurance policy. The purchaser agrees to pay any additional premiums required to keep the policy in effect and receives the death benefit when the insured person dies.

#### Life Settlements and Securities Regulation.

A viatical or life settlement agreement is a security if the agreement falls within the definition of "security." A "viatical or life settlement agreement" is defined in securities rules as an agreement for consideration for the purchase of any portion of the death benefit under an insurance policy.

A viatical or life settlement agreement does not include any agreement for the original issuance of an insurance policy or an assignment of a death benefit under an insurance policy by the original owner, or a person who has an insurable interest in the insured, to any of the following:

- the insured;
- a person who has an insurable interest in the insured;
- a dealer;
- a person who is engaged in the business of purchasing the death benefit of insurance policies;
- an assignment of an insurance policy to a financial institution as collateral for a loan; or
- the exercise of accelerated benefits in the life insurance policy.

#### Life Settlements and National Insurance Regulatory Efforts.

The National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Regulators (NCOIL) have each adopted a model law on the subject of life settlements. The NCOIL Life Settlements Model Act was adopted on November 16, 2007. The NAIC revised their Viatical Settlements Model Act on June 4, 2007. The revised NAIC model is expanded to encompass life settlements.

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### **Summary of Bill:**

#### Definitions.

The bill provides 26 definitions.

#### Insurable Interest and Stranger-Originated Life Insurance.

Stranger-Originated Life Insurance (STOLI) is defined as a practice or plan to initiate a life insurance policy for the benefit of a third-party investor who has no insurable interest in the insured when the policy is originated. The STOLI is prohibited under the act. Specific standards and examples of what is and is not STOLI are provided.

#### Licensing of Life Settlements Providers.

An unlicensed person may not enter into a contract to buy a life insurance policy or broker a policy if the owner is a resident of Washington. Applicants must pay a licensing fee of \$250. The Insurance Commissioner (Commissioner) must establish the required information for

applicants. The Commissioner must investigate each applicant and may issue a license if the Commissioner is satisfied that statutory requirements are met by the applicant. Licensees must renew the license annually. The licensing fee and the renewal fee are established at \$250.

#### Licensing of Life Settlements Brokers.

An unlicensed person may not enter into a contract to broker a policy if the owner is a resident of Washington. A broker must also be licensed as a life insurance producer. Licensing is not required if the person is a licensed attorney, certified public accountant, or an accredited financial planner. A broker must pay a fee of \$250.

#### Provider Licensing Suspension, Revocation, and Renewal.

The Commissioner may suspend, revoke, or refuse to renew the license of any licensee if the Commissioner finds that:

- the provider committed a fraudulent life settlement act;
- there was a material misrepresentation in the license application;
- the licensee or any officer, partner, member, or director is guilty of fraudulent or dishonest practices, is subject to a final administrative action, or is otherwise shown to be untrustworthy or incompetent;
- the provider demonstrates a pattern of unreasonably withholding payments to owners;
- the provider no longer meets the requirements for initial licensure;
- the provider or any officer, partner, member, or director is convicted of a felony or misdemeanor of which criminal fraud is an element;
- the provider pleaded guilty or nolo contendere with respect to any felony or any misdemeanor of which criminal fraud or moral turpitude is an element;
- the provider entered into a life settlement contract that was not approved by the OIC;
- the provider failed to honor contractual obligations set out in a life settlement contract;
- the provider assigned, transferred, or pledged a settled policy to a person other than a person allowed under the act; or
- the provider or any officer, partner, member, or key management personnel has violated any provision in the act or failed to comply with a rule or order of the Commissioner.

#### Broker Licensing Suspension, Revocation, and Renewal.

The Commissioner may suspend, revoke, or refuse to renew the license of any licensee if the Commissioner finds that:

- the provider committed a fraudulent life settlement act;
- the broker or any officer, partner, member, or director is guilty of fraudulent or dishonest practices, is subject to a final administrative action, or is otherwise shown to be untrustworthy or incompetent; or
- the broker or any officer, partner, member, or key management personnel has violated any provision in the act or failed to comply with a rule or order of the Commissioner.

#### Contract Requirements.

A person must not use a life settlement contract form or provide a disclosure statement form in this state unless first filed with and approved by the Commissioner. The Commissioner

must disapprove a life settlement contract form or disclosure statement form if, in the Commissioner's opinion, the contract or provisions in the contract:

- fail to meet the requirements of this act; or
- are unreasonable, contrary to the interests of the public, or otherwise misleading or unfair to the owner.

#### Record Retention and Reporting Requirements.

Records of all transactions must be retained by the provider for three years after the death of the insured. For any policy settled within five years of policy issuance, each provider must annually file with the Commissioner an annual statement including:

- the total number, aggregate face amount, and life settlement proceeds of policies settled during the preceding calendar year;
- a breakdown of the information by policy issue year;
- the names of the insurers whose policies have been settled;
- the names of the brokers that have settled the policies; and
- other information required by rule of the Commissioner.

#### Privacy.

As a general rule, no person or entity is allowed to disclose the identity of the insured or information that could be used to identify the insured. Exceptions are made for the specific purposes related to the settlement transaction.

Non-public personal information is subject to the federal Gramm-Leach-Bliley Act (Public Law 106-102 [1999]) and all other state and federal laws relating to confidentiality of non-public personal information. All medical information is subject to the applicable provision of state law relating to confidentiality of medical information.

#### Examination.

The Commissioner may examine the business and affairs of any licensee or applicant for a license. The Commissioner may order any licensee or applicant to information reasonably necessary to determine whether a licensee or applicant has violated the law or acted contrary to the interests of the public. Examination expenses incurred shall be paid by the licensee or applicant. The Commissioner has the discretion to accept an examination report on the licensee prepared by the licensee's state of domicile or port-of-entry state.

#### Advertising.

Advertisements must be accurate, truthful, and not misleading. A person must not:

- directly or indirectly promote the purchase of a policy for the sole purpose of, or with a primary emphasis on, settling the policy; or
- use the words "free," "no cost," or similar words in marketing the purchase of a policy.

All advertisements must comply with advertising and marketing laws and rules applicable to life insurers or brokers and with any rules adopted by the Commissioner to implement this chapter. The Commissioner has the discretion to require the submission of advertising material.

#### Disclosure to Owners.

The provider must provide a separate disclosure document that is signed by the owner and provider. This document must be provided no later than the time of application for a life settlement contract. Included in the information that must be disclosed is:

- the fact that possible alternatives to life settlement contracts exist;
- the fact that some or all of the proceeds of a life settlement contract may be taxable and that assistance should be sought from a professional tax advisor;
- the fact that receipt of proceeds may be subject to claims of creditors;
- the fact that receipt of proceeds may adversely affect the recipients' eligibility for government benefits or entitlements;
- the fact that the owner has a rescission right within 15 days;
- that assistance should be sought from a professional financial advisor;
- the amount and method of calculating the compensation paid to the broker or any other person acting for the owner in connection with the transaction;
- the date by which the funds will be available;
- the fact that the insured may be contacted for the purpose of determining the insured's health status or to verify the insured's address; and
- that a broker owes a fiduciary duty to the owner.

At the time the life settlement contract is signed, the broker must give the owner and provider a document that includes additional disclosures. Included in these disclosures are:

- a full, complete, and accurate description of all the offers, counter-offers, acceptances, and rejections relating to the life settlement contract;
- disclosure of any affiliations or contractual arrangements between the broker and any person making an offer in connection with the proposed life settlement contracts;
- the name of each broker who receives compensation and the amount of compensation received by that broker; and
- a complete reconciliation of the total amount bid by the provider to the net amount of proceeds or value to be received by the owner.

The failure to provide the disclosures is an unfair trade practice.

#### Disclosure To and From Insurers.

An insurer may inquire whether the proposed owner intends to pay premiums with the assistance of financing from a lender that will use the policy as collateral. If the loan provides funds which can be used for a purpose other than obtaining and maintaining the life insurance policy and loan, the application must be rejected. If the financing is not in violation of this act, the insurer may make specific disclosures to the applicant and the insured.

#### General Requirements.

An insurer must notify a policyholder that is 60 years or older or is known to be terminally ill, that there may be alternative transactions available if:

- the owner makes a request to surrender the policy;
- the owner requests an accelerated life insurance benefit;
- the insurer is sending out a laps notice; and
- other times required by rule of the Commissioner.

A provider entering into a life settlement contract with the owner of a policy where the insured is terminally or chronically ill must obtain the insured's consent to the release of his or her medical records. If the owner is the insured, a provider must obtain a written statement from a licensed attending physician that the owner is of sound mind and under no constraint or undue influence to enter into a settlement contract.

Before or at the time of execution of the settlement contract, the provider must obtain a witnessed document in which the owner:

- consents to the settlement contract;
- represents that the owner has a full and complete understanding of the settlement contract, and the policy;
- acknowledges that the owner is entering into the settlement contract freely and voluntarily; and
- acknowledges, if it is the case, that the insured has a terminal or chronic illness that was diagnosed after the policy was issued.

All life settlement contracts must provide that the owner may rescind the contract within 15 days after the date it is executed. The owner must repay all sums paid by the provider within the rescission period. If the insured dies during the rescission period, the contract is considered rescinded subject to repayment of sums by the owner or the owner's estate to the provider.

A person must not enter into a life settlement contract within two years of the beginning of a policy. This does not apply if the policy was issued upon the owner's exercise of conversion rights and the total of the time covered under the conversion policies is at least 24 months. It also does not apply if the owner submits independent evidence to the provider that one or more of the following conditions have been met within the two-year period:

- the owner or insured is terminally or chronically ill;
- the owner or insured disposes of his or her ownership interests in a closely held corporation under an agreement in effect when the policy was issued;
- the owner's spouse dies;
- the owner divorces his or her spouse;
- the owner retires from full-time employment;
- a physician determines that a mental or physical disability prevents the owner from maintaining full-time employment; or
- a final order, judgment, or decree is entered by a court of competent jurisdiction.

#### Prohibited Practices.

It is unlawful for any person to engage in prohibited practices, including:

- entering into a life settlement contract if such person knows or reasonably should have known that the policy was obtained by means of a false, deceptive, or misleading application;
- engaging in any transaction or practice if the person knows or reasonably should have known that the intent was to avoid the notice requirements of this chapter;
- engaging in any fraudulent act involving an owner who is a resident of this state; or
- promoting the purchase of an insurance policy for the purpose of, or with, an emphasis on settling the policy.

A violation of a prohibited practice is a fraudulent life settlement act.

#### Fraud Prevention.

A person must not:

- commit a fraudulent life settlement act;
- knowingly and intentionally interfere with the enforcement of this act or investigations of suspected or actual violations of this act; or
- knowingly or intentionally permit any person convicted of a felony involving dishonesty or breach of trust to participate in the business of life settlements.

Any person engaged in the business of life settlements having knowledge of a reasonable belief of a fraudulent life settlement act must provide the information to the Commissioner.

Providers and brokers must have antifraud policies and must submit an antifraud plan to the Commissioner.

#### Injunctions and Civil Remedies.

The Commissioner may investigate to determine if a person has violated this act. The Commissioner may issue a cease and desist order upon a person who violates any provision of this act, any rule or order of the Commissioner, or any written agreement entered into with the Commissioner. The Commissioner may seek an injunction in court.

Any person damaged by a violation of the act or any rule implementing this act may bring a civil action for damages.

#### Penalties.

A person that knowingly commits a fraudulent life settlement act or knowingly acts as a broker or provider without a license is guilty of a class B felony.

Additionally, the Commissioner may impose a civil penalty not exceeding \$25,000 for knowingly acting as a broker or provide without a license.

#### Application of the Consumer Protection Act.

A violation of the act is a violation under the Consumer Protection Act (CPA) (chapter 19.86 RCW).

#### Authority to Adopt Rules.

The Commissioner may adopt rules implementing and administering the act.

#### Conflict of Laws.

The laws of the state of the owner take precedence in a conflict in the laws between an owner and a purchaser in a transaction.

#### Repeal of Existing Viatical Laws.

At the time this act becomes effective:

- the existing viatical laws are repealed;
- any existing viatical broker licenses are expired; and

- any existing viatical provider licenses are converted to life settlement contract licenses.

Converted life settlement licenses must be in compliance with licensing components of this act at the next date of renewal.

Public Records Act.

Information regarding individual owners and insureds is exempt from disclosure under the Public Records Act.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

**Staff Summary of Public Testimony:**

(In support) This was the subject of a bill last session. The issues were not resolved at that time so the stakeholders worked on the subject over the interim. This bill was crafted as compromise legislation that could be supported by all parties. One of the unique and important features is that the policyholder receives disclosure notice from the insurer at the time that the policy may lapse that informs the policyholder that they may have other options. This disclosure may be the first of its type in the nation. This is a compromise bill supported by all parties. The United State Supreme Court and the Washington Supreme Court have both recognized that a life insurance policy is property that can be sold by the owner. A policy is an asset that an owner may choose to liquidate. The bill does three major things. First, it protects property rights. Second, it protects consumers. Third, it addresses concerns related to Stranger-Originated Life Insurance (STOLI). The bill is based on the National Conference of Insurance Regulators (NCOIL) model. That is the model that a large majority of states are using when they enact legislation in this area. Most of the differences between this bill and the NCOIL model are cleaning up language and making technical changes. Life insurers are on the other side of life settlement companies on many issues. Life insurers do support this bill. Both sides have compromised. This subject goes to the heart of the insurable interest concept. Viatical settlements were a problem before they were regulated. This area is where clear, strong regulation would benefit all parties. The discussions and negotiations on this bill were not easy. Both sides gave on issues. One key element in this bill is there is a clear definition of STOLI and that practice is prohibited. It is important to preserve the insurable interest standard in life insurance. The NAIC and the NCOIL models as well as House Bill 3067 from last year and this bill all recognize that the need for an insurable interest in the life of an insured person. The disclosure provisions related to an insurer were a concern. The life insurers wanted to make sure that any required content in the notices did not recommend alternatives instead of providing notice of alternatives. There was also a concern about the cost of the notices. Those issues aside, the bill as a whole is supported by the life insurers. The bill provides valuable consumer protections.

(Opposed) None.

**Persons Testifying:** Senator Berkey, prime sponsor; Carrie Tellefson and Michael Freedman, Coventry; Jeffery Lawrence, Symetra; Mary Clogston, Office of the Insurance Commissioner; and Mel Sorensen, American Council of Life Insurers and the National Association of Insurance and Financial Advisors.

**Persons Signed In To Testify But Not Testifying:** None.